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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1953

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No.

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WILLIAM B. STAYBACK, *Petitioner,*

v.

THE UNITED STATES OF AMERICA, *Respondent.*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

---

*To the Honorable Chief Justice and Associate Justices of The Supreme Court of the United States:*

The petitioner, William B. Stayback, prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Third Circuit in the above case.

## JUDGMENT AND OPINION OF THE COURTS BELOW

The judgment of the United States District Court for the District of New Jersey was entered January 30, 1953 and is not reported but is printed in the Record. (D10a)*

The opinion of the United States Court of Appeals for the Third Circuit is reported at — F. 2d — (R. 228).

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* References with the letter "D" indicate the page numbers of the Appendix for Appellant (Defendant) in the court below, certified as part of the Record.

## JURISDICTION

The judgment of the United States Court of Appeals for the Third Circuit was entered April 21, 1954 (R. 228). The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1), 62 Stat. 928.

## QUESTIONS PRESENTED

1. Did the Court below extend the Income Tax Act beyond the scope of the Sixteenth Amendment to the Constitution by holding that the Government had only to show unreported *gross receipts* in order to make out an offense under Sec. 145(b), Internal Revenue Code (26 U.S.C.A. sec. 145(b)?

2. Has the Court below in effect shifted the burden of proof to defendant in this criminal case in violation of the Fifth Amendment to the Constitution?

## STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code are set out in the appendix to this petition.

## STATEMENT

The petitioner on January 30, 1953, was adjudged guilty as charged on a two-count indictment for filing false and fraudulent income and victory tax returns for the years 1943 and 1944, to which he had pleaded not guilty, and he was sentenced by the United States District Court for the District of New Jersey to imprisonment for eighteen months and fined $3,000 and costs. (D10a)

An appeal was taken to the United States Court of Appeals for the Third Circuit and opinion and judgment were rendered on April 21, 1954 affirming the judgment of the District Court. (R. 228-239)

The petitioner during the years 1943 and 1944 was engaged in the manufacture and sale of metal novelties and souvenirs at 38 Old Broadway, New York, and on Grand

Avenue, Palisades Park, New Jersey. (D41a, D65a-66a, D82a-83a)

For the year 1943 the petitioner and his wife filed a joint individual income and victory tax return (Ex. G-1; D17a, D251a-255a) in which there was reported as income "Net profit from business $8,115.00," computed as follows:

| | | |
|---|---|---|
| Total Receipts | | $15,000.00 |
| *Cost of Goods Sold:* | | |
| Inventory at beginning of year | $4,000.00 | |
| Materials and supplies | 3,585.00 | |
| Total | 7,585.00 | |
| Less Inventory at end of year | 2,000.00 | |
| Net Cost of goods | | 5,585.00 |
| Gross profit | | 9,415.00 |
| *Other business deductions:* | | |
| Rent, repairs and other expenses (See list) | | 1,300.00 |
| Net Profit | | $ 8,115.00 |

The deductions for expenses of $1,300 are not in dispute (D159a). There was further deducted on page 1 of the return amounts for contributions, interest and taxes paid, aggregating $980, which are also not in dispute and not here involved (D160a). The return showed net income of $7,135 subject to income tax and $8,115 subject to Victory tax, upon which there was computed a total income and victory tax of $1,534.09. (D149a, D255a)

For the year 1944 petitioner and his wife filed a joint individual income tax return (Ex. G-2; D17a, D256a-258a) in which there was reported as net profit from business $1,553.29, computed as follows:

| | | |
|---|---|---|
| Total Receipts | | $ 4,000.00 |
| *Cost of Goods Sold:* | | |
| Inventory at beginning of year | $2,000.00 | |
| Materials and supplies | 185.61 | |
| Total | 2,185.61 | |
| Net Cost of goods | | 2,185.61 |
| Gross profit | | 1,814.39 |
| *Other business deductions:* | | |
| Rent, repairs and other expenses (Schedule G) | | 261.00 |
| Net Profit | | $ 1,553.39 |

Petitioner Stayback was in business for himself for only two months in 1944 because in March 1944 the business was taken over by the Lee Manufacturing Co. (D31a-32a)

The deductions for expenses of $261.00 are not in dispute (D163a). There was further deducted on said return amounts for contributions, interest and taxes paid, aggregating $975.00, which are also not in dispute. The return showed net income subject to tax $578.39, upon which there was computed income tax of $2.35. (D258a)

Petitioner's tax returns for these two years, 1943 and 1944, were prepared by an accountant, John F. Primoshic, in the year 1946, who testified that the petitioner did not at that time have any books and records for "William Stayback" and that the returns were prepared by him from estimates made by petitioner of his total receipts from business for the year 1943 and for the first two months of 1944, that that was the only income he had, and that he (Primoshic) computed the cost of goods sold and other business deductions (except for rent) stated on the return upon a percentage basis from his knowledge of and familiarity with that particular type of business and his general accounting experience. (D27a-29a, D31a-37a)

Revenue Agent Henry Lieberman, a Government witness, employed by the Bureau from 1944 to 1947, testified on direct examination that he investigated petitioner's affairs in late 1945 and 1946, and that petitioner submitted to him an affidavit explaining why the returns were delinquent, that the petitioner had been in poor health and had been in the Mayo Clinic in Rochester; and that as a result he recommended that no penalty for delinquency be assessed. (D21a-22a, D25a-26a)

Revenue Agent John Cassidy testified that thereafter in 1949 he made an investigation of the returns for the year 1945 of petitioner Stayback and his company, the Lee Manufacturing Company, a corporation which was organized by petitioner to take over the metal novelty business in 1944, and that investigation disclosed that petitioner had made sales under various trade names that were not reported in his returns for the years 1943 and 1944. (D143a-155a)

Mr. Cassidy testified that he went to petitioner's place of business on January 7, 1949 (D150a), which was then located in River Edge, New Jersey (D146a) and interviewed petitioner with reference to the sales under investigation, and that later in April and May 1949 he examined books and records of Lee Manufacturing Co., petitioner's company (D145a) and petitioner gave him some records of his bank account, cancelled checks and check stubs for some months (D165a) and some records for the W.S. Novelty Co., the predecessor business (D167a).

Mr. Cassidy testified that for the year 1943 the total sales were $104,667.38 which was $89,667.38 in excess of the $15,000 sales shown on the return; and that for the year 1944 the total sales were $59,373.40, which was $55,373.40 in excess of the $4,000 sales shown on the return (D156a-157a)

Upon that basis, Revenue Agent Cassidy testified that he recomputed the net income of petitioner for each of the years, using the figures shown on the returns for "cost

of goods sold'' without allowance for any additional costs of manufacture, such as materials, supplies or labor, other than an amount of $16,218.18 payroll (labor) cost for 1943 that he obtained from a payroll exhibit of one of the accounts. (D158a-160a, 194a, 203a) For the year 1943 Mr. Cassidy computed a net income of $80,544.20 and a tax liability of $50,445.53, as follows: (D158a-160a)

| | | |
|---|---|---|
| Total Receipts | | $104,667.38 |
| *Costs of Goods sold* | | |
| As shown on return | $ 5,585.00 | |
| Plus Payroll (labor) | 16,218.18 | |
| Net cost of goods sold | | 21,803.18 |
| Gross profit from business | | 82,864.20 |
| Less Business deductions shown on return | | 1,300.00 |
| Net Profit or net income from business | | 81,564.20 |
| Less deductions shown on return for contributions, interest and taxes | | 980.00 |
| Net income | | $ 80,584.20 |
| Total tax | | $ 50,445.53 |

For the year 1944 Mr. Cassidy computed a net income of $55,951.79 and a tax liability of $32,197.39, computed as follows: (D162a-163a)

| | |
|---|---|
| Total Receipts | $ 59,373.40 |
| Net cost of Goods sold as shown on return | 2,185.61 |
| Gross profit from business | 57,187.79 |
| Less Business deductions shown on return | 261.00 |
| Net Profit or net income from business | 56,926.79 |
| Less deductions for contributions, interest and taxes shown on return | 975.00 |
| Net income | $ 55,951.79 |
| Total tax | $ 32,197.39 |

Mr. Cassidy testified that he gave the petitioner credit for additional cost of goods in the amount of $16,218.18 for payroll or labor in the 1943 computation but that he didn't give any credit for additional cost of goods in 1944 because he didn't find any, and that petitioner Stayback or his attorney didn't elect to present any at the time of the preparation of his report (D164a).

Mr. Cassidy made no allowance in his computation of net income for either 1943 or 1944 for costs of additional materials or supplies used in the manufacture of the additional sales, notwithstanding the fact that government witness Clifford Allen, Stayback's employee, testified that he purchased quantities of metal for them at the then prevailing price of about five or six hundred dollars a ton; and that a ton of metal would not make a ton of novelties, there being a certain loss in the business; that some of the metal purchases were made in New York and some in Brooklyn; that one place where he purchased metal was Landau, a scrap place on 126th Street, where Allen had bought lead 2 or 3 times, usually a ton at a time; that he also bought metal at Greenpoint Metal in Brooklyn, "maybe once a week"; and that there was one other place he went for metal, in Brooklyn, three or four times during 1943 and 1944. (D112a, D113a, D116a, D119a, D120a, D121a-122a)

(There was no testimony in the case that the foregoing constituted all of the purchases of metal for the petitioner's business in 1943 and 1944.)

Reverting to Mr. Cassidy's testimony, he stated that he did not follow any "net worth" theory in determining the petitioner's taxable income. He just confined himself to the specific items of sales. (D181a-182a)

At the close of the Government's case, counsel for defendant (petitioner) moved for a verdict of acquittal (D203a)

> "because the evidence that has been introduced is as consistent with innocence as it is with guilt, and there

> is nothing upon which the jury could determine a verdict of guilt."

The motion was denied. (D203a)

At the close of the whole case, counsel for the defendant (petitioner) renewed his motion for a verdict of acquittal (D213a)

> "upon the grounds that were set forth at the end of the Government's case,"

and that (D216a-217a)

> "the Government has not sustained the burden of proof that the defendant wilfully intended to evade taxes by understatement of the net income on his returns. The Government has shown only gross sales and gross receipts, and has not proved the gain or profit in the sales. The Government has made no allowance for the cost of materials,"

and that (D219a)

> "in a criminal matter * * * it is the duty of the agents when they make a compilation to set forth * * * the costs of manufacture * * * that go to the marketing of this product, and that hasn't been done in this case,"

and, finally, that (D219a-220a)

> "I fail to find, if your Honor please, in this entire case any evidence of a net income, true net income, * * *."

This motion, also, was denied (D220a).

## SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals for the Third Circuit erred:

1. In holding that petitioner does not dispute the accuracy of the Government's testimony that he understated his "gross income."

2. In holding that the burden was on petitioner to establish the "allowable operating costs" in determining the income received from the additional unreported sales.

3. In holding that the Government by its testimony established "unreported income of almost $90,000 in 1944 (sic) and more than $55,000 in 1943 (sic)."

4. In affirming the judgment of the United States District Court for the District of New Jersey.

## REASONS FOR GRANTING THE WRIT

**1. The decision of the Court of Appeals is in conflict with decisions of this Court.**

The Sixteenth Amendment to the Constitution empowers Congress to levy a tax on income, which means at least gross income and not gross receipts.

The decision of the Court of Appeals for the Third Circuit is in conflict with the decisions of this Court in that the Court approves the Government's computation of petitioner's net income and the tax due thereon from the additional sales for each of the taxable years 1943 and 1944 upon the basis of gross receipts, without allowance for costs of goods sold (except for one labor charge of $16,218 for 1943), which is contrary to the rule laid down in *Southern Pac. Co.* v. *Lowe*, 247 U.S. 330, 335, 38 Sup. Ct. Rep. 540, 62 L. Ed. 1142, 1147, and *Doyle* v. *Mitchell Bros., Inc.*, 247 U.S. 179, 184, 38 Sup. Ct. Rep. 467, 62 L. Ed 1054, 1059, because the gross receipts may include return of capital as well as income and it is very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor. *Goodrich* v. *Edwards*, 255 U.S. 527, 535, 41 Sup. Ct. Rep. 390, 65 L. Ed. 758, 762.

This is a criminal case, and the Government has the burden to prove beyond a reasonable doubt, that the income and the tax due thereon were understated in the return filed.

The Government to establish its case must prove not only an attempt wilfully to defraud but it also must prove that a tax in addition to what the petitioner has already paid remains due and owing. *United States* v. *Schenck*, 126 F. 2d 702, 704 (CCA 2) (Cert. denied 316 U.S. 705). The tax is imposed on net income as distinct from gross income or gross receipts, and the terms are not synonymous. Gross receipts is a broader term, including with it receipts which may constitute capital as well as income, and returns of capital may not be taxed. *Doyle* v. *Mitchell, supra, and Southern Pac. Co.* v. *Lowe, supra.*

Section 21 Internal Revenue Code (26 USCA sec. 21) defines "Net income" as "gross income computed under Section 22, less deductions allowed by Section 23."

"Gross income" as defined in Section 22(a) includes gains, profits, and income derived from business or sales, or the transaction of any business carried on for profit, such as manufacturing business in the present case. Therefore, where a manufacturer processes raw materials and constructs therefrom a finished product, and sells such product, to the extent that the sale price exceeds the cost of goods sold, that is, costs of materials and labor, it is gross income to the manufacturer. *Sunray Oil Co.* v. *Com'r of Internal Revenue*, 147 F. 2d 962, 966 (CCA 10). That definition of gross income is specifically clear from Treasury *Regulations 111* (1946) which provide:

> "Reg. 111, Sec. 29.22(a)-5. Gross income from business.—In the case of a manufacturing, merchandising, or mining business, 'gross income' means the *total sales, less the cost of goods sold*, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold. * * *"
>
> (Emphasis supplied)

Only profits and income from business constitutes gross income. It is only after such profit has so been determined (constituting gross income) that further deductions are

to be made therefrom as authorized by Section 23 I.R.C. in order to arrive at the net income which is taxable. *Anderson Oldsmobile, Inc.* v. *Hofferbert,* 102 F. Supp. 902, 905 (D.C. Md.), affirmed in *Hofferbert* v. *Anderson Oldsmobile,* 197 F. 2d 504, 508 (CCA 4), cert. denied 73 Sup. Ct. Rep. 24.

The gross gain or profit from sales, therefore, must be determined before the allowance of statutory deductions provided in Section 23 I.R.C. There is no express provision that even allows the manufacturer or merchant to deduct the cost of goods that he sells. *Doyle* v. *Mitchell Bros., Inc., supra,* at page 184. Those statutory deductions under Section 23 I.R.C. are generally for expenses in connection with production of income, and are specifically defined in the statute as business expenses, interest, taxes, losses, bad debts, contributions, depreciation, etc.

In this case we are only concerned with the determination of gain or profit on the unreported sales of merchandise, which requires a determination in each year of not only (1) the total gross receipts for such sales, but (2) the costs of materials, supplies and labor that make up the "Cost of Goods Sold." The so-called business deductions for rent, repairs and other expenses, as well as the other statutory deductions for contributions, interest and taxes paid, are not in dispute and are not here involved.

The most important factor in the determination of gross income derived from the manufacture and sale of any product is the cost of goods sold, viz. the cost of materials and the cost of labor.

The Court in its opinion has stated that petitioner (defendant below) does not dispute the accuracy of the Government's testimony that he understated his "*gross income*" by $89,667.39 in 1943 and $55,373.40 in 1944. That is not a correct statement. Those amounts represent the additional *gross sales* (not the gross income) for those years. The Government has the burden to prove the cost of goods sold, viz. cost of materials, supplies and labor, in those sales before the Government may make any determination of "gross income." *Anderson Oldsmobile, Inc.*

v. *Hofferbert, supra,* at page 905. For the year 1943 the Government has allowed $16,218.18 labor costs for additional sales of $89,667.39, but has allowed nothing whatever for costs of materials, such as metal, in the production of those sales. Government witness Allen testified that the cost of metal in those years was $500 to $600 a ton, which would be a substantial factor in the production of sales aggregating $89,667 in 1943 and $55,373 in 1944. (D111a)

For the year 1944 the Government has allowed nothing for costs of either labor or materials in the manufacture of the additional sales of $55,373.40.

The costs of materials listed in the returns as $5,585 for estimated sales of $15,000 in 1943 and the costs of $2,185.61 for estimated sales of $4,000 in 1944, are some indication that in a business of this kind the costs of raw materials used in the manufacture of such products are substantial items. That in itself is proof that the Government has not even attempted to show the gain, profit, or income from the said additional sales, but that it has arbitrarily taxed the entire additional gross sales (less the one labor cost item of $16,218.18) as income to petitioner.

The Court is clearly wrong, therefore, in concluding that the Government has established "*Unreported income.*" Gross receipts and gross sales, without consideration of costs of goods manufactured and sold, are not income as defined by the statute.

The assumption by the Government, by its witness Cassidy and by the Court below, that all of the cost of materials and supplies was reflected in the returns, was not only definitely disproved by the Government's own evidence (witnesses Allen and Primoshic), but was without evidentiary support even from permissible inference on the face of the returns, considered in connection with the corrected "Total receipts." Such an assumption cast the burden of proof upon the petitioner to show that he did not have taxable income in either of the indictment years in excess of the amounts returned. The latter procedure cannot be approved. "It should always be necessary that

the facts and circumstances put in evidence by the Government justify, by reasonable inference at least, the truth of the assumed fact." *Kirsch* v. *United States,* 174 F. 2d 595, 601 (8th Cir. 1949). In the instant case, there was no foundation for the assumption; and the shifting of the burden of proof to the petitioner by such assumption was entirely without warrant in our criminal law. *United States* v. *Fenwick,* 177 F. 2d 488, 492 (CCA 7).

The Government did not produce any evidence of unexplained funds or property in the hands of petitioner, and there was no attempt made to compute petitioner's income on a net worth basis.

The Court below in its opinion states that the burden is on the petitioner to prove that he had other allowable deductions which were not shown on the return, citing *United States* v. *Smith,* 206 F. 2d 905 (CCA 3), *United States* v. *Link,* 202 F. 2d 592 (CCA 3), and *United States* v. *Hornstein,* 176 F. 2d 217 (CCA 7). But in a criminal case the burden of proof is on the Government.

The *Smith* case involved only items of dividends, interest and capital gains and did not require the computation of net profits from a manufacturing business. The *Link* case was that of a bookmaker and the figures for both gross rec pts and deductions were proven by the Government. There, the Government allowed deductions of $800,000 from gross receipts of $1,063,000 and thus sustained its burden of proof.

The *Hornstein* case was that of a diamond merchant whose tax returns were prepared by accountants at his request from books and records furnished to them by Hornstein, which records showed substantial amounts as costs of goods sold, $16,847 for 1941 and $47,581 for 1942; and in addition defendant showed purchases of goods in 1942 of $66,426.50. Furthermore, the defendant attempted to produce evidence that the figures were in error and that the costs were greater than that shown by the books. The Government, therefore, maintained its burden of proof in showing the costs of goods sold from the evidence produced in his books and records and evidence of purchases of

$66,426.50 goods in 1942. That is an entirely different situation from the present case, where the petitioner had no records and the Government proved no costs of materials and only proved one item of labor costs for all of the additional sales aggregating $89,667 in one year and $55,373 in the other year.

Indeed, if it were not for the fact that each of the tax returns for 1943 and 1944 stated that there was taxable income, the Government's evidence would have been insufficient to establish that there was *any* taxable income for either year. *A fortiori,* the Government's proof is insufficient to establish that the petitioner was in receipt of a taxable income in either of the indictment years *exceeding* the amounts reported by him in the respective returns. This is so because, in order to justify the submission of a criminal cause of the instant character to the jury, there must be substantial evidence of facts which exclude every other hypothesis but that of guilt. *Nicola* v. *United States,* 72 F. 2d 780, 786 (Third Circuit, 1934); *United States* v. *Fenwick, supra.* The case at bar should not have been submitted to the jury by the trial judge, since the Government's proofs did not exclude the hypothesis that the total "cost of goods sold" in either of the indictment years, especially including the cost of raw materials, may have been so large that the gross income shown on the tax returns was not understated.

**2. The Decision of the Court Below Shifts the Burden of Proof to Petitioner in Contravention of the Fifth Amendment to the Constitution.**

This case raises a question of the scope and application of protection afforded petitioner by the Fifth Amendment to the Constitution. The Court below has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by the District Court, as to call for an exercise of this Court's power of supervision and warrant the granting of the writ.

The burden is upon the Government to prove guilt beyond a reasonable doubt, and to prove facts consistent

with a state of guilt and inconsistent with a state of innocence. The rule imposes upon the Government the burden of proving the existence of every element necessary to constitute the crime charged. *Davis* v. *United States,* 160 U.S. 469, 487-88, 16 Sup. Ct. Rep. 353, 40 L. Ed. 499, 505-6. Thus, in the present case, the Government has the burden to prove unreported gross income and the tax resulting from the additional sales in each year, after subtraction of the cost of goods sold.

The mere sale in itself is not a presumption of profit, and if there is no profit there is no income and no tax due. The petitioner was the only person who could testify in contradiction of the Government's charge. See *Tot* v. *United States,* 319 U.S. 463 (1943), 63 Sup. Ct. 1241, 87 L. Ed. 1519.

If, therefore, as the Court below ruled, the burden is shifted to petitioner (defendant below) to prove the negative, and to prove that no income was realized on the additional sales and no tax resulted therefrom, then he is compelled, in violation of the Fifth Amendment to the Constitution, to take the stand and be a witness in a proceeding against himself. In such case the Court would deprive petitioner of life, liberty, and property without due process of law.

The decision of the Court below has sanctioned such a departure by the District Court from the accepted and usual course of judicial proceedings as to violate the Fifth Amendment to the Constitution.

## CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

RICHARD S. DOYLE
JOHN E. TOOLAN
JULES G. KÖRNER III
*Counsel for Petitioner*

*Of Counsel:*
BLAIR, KÖRNER, DOYLE & APPEL
TOOLAN, HANEY & ROMOND

## APPENDIX

### Statute Involved

The pertinent provisions of the Internal Revenue Code are:

**Sec. 145. Penalties**

* * *

**(b) Failure to collect and pay over tax, or attempt to defeat or evade tax.** Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

26 USCA Sec. 145(b), 52 Stat. 513.

* * * * *

**Sec. 21. Net income**

**(a) Definition.** "Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

26 USCA Sec. 21(a), 52 Stat. 457.

* * * * *

**Sec. 22. Gross income**

**(a) General definition.** "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, or profit, or the transaction of any business car-

ried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

26 USCA Sec. 22(a), 52 Stat. 457, 53 Stat. 575.

* * * * *

**Sec. 23. Deductions from gross income.** In computing net income there shall be allowed as deductions:

**(a) Expenses**

**(1) Trade or business expenses.**

**(A) In general.** All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

26 USCA Sec. 23(a), 52 Stat. 460.